I

THE FIRST THREAT

Fundamental Economic Decline— The Macroeconomic Dimension

Is the United States undergoing a process of cumulative economic deterioration vis-à-vis other industrial nations, or simply receding a bit from the exceptional position of supremacy it enjoyed in the decades after the devastation of Europe and Japan? Colloquially, is the United States in decline as a great power?

The U.S. share of world output is declining, our productive lead is being eroded by faster-growing economies, the competitive position of our industries has weakened, our trade is in deficit, and our capital position has been transformed abruptly from net lender to net debtor—so writes Paul Kennedy in *The Rise and Fall of the Great Powers*. "It is instructive to note the uncanny similarities between the growing mood of anxiety among thoughtful circles in the United States today and that which pervaded all political parties in Edwardian Britain. . . . In terms of commercial expertise, levels of training and education, efficiency of production, standards of income and (among the less well-off) of living, health, and housing, the 'number one' power of 1900 seemed to be losing its position, with dire implications for the country's long-term *strategic* position."[2]

On the contrary, counters Joseph Nye, the extrapolation of decline from the most recent decades of American economic performance ignores the ab-

normal impact of World War II. Studies that allow for the recovery of Europe and Japan suggest that "the World War II effect lasted for about a quarter century and that most of the decline worked its way through the system by the mid-1970s and then stabilized." Much of the erosion of American preponderance since the 1950s is simply a "return to normal."[3]

This questioning of America's standing in the world system is not new. Samuel Huntington finds repeated phases of "declinism" in recent American history (five in the postwar era alone). Our preoccupations with decline, he concludes, may be "better indications of American psychology than of American power."[4]

Is the United States in decline or not? How can we know if America's position vis-à-vis its industrial rivals now rests in rough equilibrium, or is following a downward trajectory? Could the decline debate be simply another iteration of Huntington's phases, more a function of America's psyche than a reflection of the underlying reality?

A comprehensive assessment of America's place in the future world system could surely benefit from surveying centuries of comparative history (Kennedy), from including "soft power" resources of values and ideals (Nye), from psychoanalyzing America's view of itself (Huntington). In the end, a dynamic explanation of what propels a great power along one path or another might well depend on intuitive ponderings that would leave the national strategist with no concrete way to know until long after the fact, let alone measure from year to year or decade to decade, the answer to the question.

The Contribution of Macroeconomics to the Decline Debate

The focal point for the economics discipline is just the opposite; it is simple, measurable, mundane in the extreme. To confront the challenge of analyzing whether the United States is undergoing a process of fundamental deterioration in its economic position relative to other nations, the natural starting place for economists is the relationship between consumption and savings in the United States in comparison to the corresponding ratio in its major industrial rivals. This approach does not pretend to account for all the facets of a great power in decline, but it does explain very clearly one key element, the direction of the trend in trade and capital flows (positive or negative), and predicts with some certainty how long an adverse trend will last. This, in turn, helps lay the basis for understanding the competitive position of American industries and the potential deterioration in the capabilities, economic and technological, to be found in the United States (Threat II), and, concomitantly, the growing susceptibility to foreign influence and foreign control (Threat III).

Drawing on the first lesson of Macroeconomics 101, this approach produces conclusions more dramatic than those of Paul Kennedy, more portentous than those of Joseph Nye, more concrete than those of Samuel Huntington, and different from all three. Its impact on policymakers, however, is usually not far different from the effect in the classroom—namely, a mix of confusion and sopor.

The most basic macroeconomic equations demonstrate that so long as the United States consumes more than it produces and does not save enough to finance new productive capacity to fill the consumption/production gap, there will be a trade deficit caused by the excess demand of U.S. consumers and capital inflows to make up for the deficiencies in savings. The trade deficit puts dollars into the hands of foreigners who treat them like IOUs, cashing them in over time to buy either products or assets (carrying the balance in the form of debt). Ultimately, the nation can pay off the amassed IOUs by expanding production in excess of domestic consumption or by selling off assets. The actual course of events, in which the United States evolves as a net seller of products or a net seller of assets, depends upon the consumption/savings ratio of others in comparison to ours. If we do not reduce our consumption and upgrade and enlarge the nation's production facilities with our own savings, foreigners will increasingly do it for us. But not in exact proportion: more likely is the troublesome combination of a weakly capitalized productive base, along with a steadily rising foreign accumulation of assets.[5]

Somber Implications

The implications of a high-consumption/low-savings ratio are profound: the deterioration in the trade and investment accounts will not stop until the ratio is altered. From the legacy of imbalance, moreover, national strategists face a future of fewer and fewer resources to meet national and international needs (as a rising proportion of domestic output must be dedicated to paying off accumulated debts), accompanied by a growing foreign presence in our midst.[6]

In this context, U.S. economic behavior has undergone in the last decade what in the glacial tectonics of macroeconomics constitutes a dramatic shift. According to the *Economic Report of the President*, from 1980 to 1990 consumption exceeded production by $1.2 trillion, creating trade deficits of approximately the same magnitude.[7] The trade deficits alone are not inherently "bad." If they had been accompanied by a high savings rate and if they had represented a vast inflow of capital equipment to renovate the economy, one could hope they would pay for themselves in new products and higher productivity. Instead, the trade deficit has been largely dedicated to satisfying consumer demand, mortgaging the country's future to finance current consumption. From 1980 through the early 1990s, gross national savings declined from 20 percent of GNP to 16 percent of GNP, reflecting a growth in the federal deficit (government dissaving), a decline in state and municipal surpluses, and a fall in private household and business savings.

Over the same period, the consumption and savings patterns of our major economic rivals, Germany and Japan, have been in many ways the mirror image, with production exceeding consumption by $954 billion, generating trade surpluses of the same magnitude. Their savings rates, meanwhile, have maintained an average of 23 percent and 32 percent of GNP, respectively. In the process, Europeans and Japanese have been compensating for some of the decline in American savings by doing it for us, reaching a high in the late 1980s of supplying approximately half of all our domestic investment.[8]

The meaning of this macroeconomic analysis for national strategy is somewhat counterintuitive to popular thinking: the fiercest Japan-bashing or EC-92–bashing in trade negotiations and the toughest "strengthening" of investment regulation via legislation like the Exon-Florio Amendment will not right the imbalances in trade and investment unless the underlying savings/consumption ratio in the United States is transformed. This arcane truth, accepted as gospel by the economics community, has been largely lost in the public policy debates. Macroeconomists convey an unpopular (and sometimes unwelcome) message when they declare that trade liberalization and foreign investment restrictions are not remedies in themselves: efforts on the part of a deficit country to achieve more openness from others and tighter closedness for itself can alter the composition of the nation's international imbalances but, in the absence of changes in the consumption/savings ratio, cannot change their magnitude. In a fundamental sense, our trade and investment deficits are indeed "Made in America."[9]

Furthermore, trade liberalization by other nations in response to U.S. demands may simply make them even more competitive in comparison to us as they incorporate productivity-enhancing products, including U.S. products—from microprocessors, to telecommunications switching gear, to cheap wheat and rice—into their economies.

Will Demographics Save Us?

Some will argue that an apocalyptic response to the deterioration of America's economic position over the past decade or so is unwarranted, given the shifting demographics of the Japanese and European populations in comparison to our own. Over time, the greater proportion of the elderly (who per-force consume more and save less than younger workers) in the Japanese and European societies might reestablish a balance in our trade and capital accounts.

But the aging population in Japan will not reach its crest until after 2020, in Europe only slightly earlier. Over the intervening years, the accumulation of dollar surpluses abroad will, by any historical measure, rise to massive proportions. The pressure of international market forces to spur exports—and force reductions in domestic consumption via almost certain devaluations of the dollar—will mean a steady decline in the American standard of living, and a declining capability to influence events on the world stage. The buildup of the foreign presence in U.S. economy that will occur along the way is difficult to estimate with anything resembling exactitude, but its dimensions (perhaps 30–40 percent of the capital stock)[10] could have much greater strategic implications for the United States than we can even imagine today (when foreigners own 10 percent of U.S. capital stock). Complacency about relying on demographic trends abroad to right macroeconomic disparities at home, therefore, leaves open a window of vulnerability for at least three decades.

Window of Vulnerability, Window of Opportunity

Broadly speaking, then, the contribution of macroeconomics to the decline debate comes out rather

solidly on the affirmative side: the United States is set on a downward trajectory and, in the absence of fundamental behavioral changes, it will continue along this course. This conclusion differs, however, from Paul Kennedy's point of view and is in some ways even more gloomy. Kennedy blames the military expenditures that accompany "imperial overstretch" for the weakening of American economic performance. One might suppose, therefore, that the cutback in military spending engendered by the end of the cold war will help restore our economic health. But as the preceding macroeconomic analysis reveals, even if the United States cut back its political commitments and slashed its defense outlays (America could withdraw from East of Suez!), the cumulative decline of the United States will continue unabated if the resulting revenues go to consumption rather than investment. Much of Kennedy's analysis of the role of imperial overreach in the rise and fall of nations can be reduced, in fact, to a special case of the need to pursue macroeconomic stability, with military commitments being "excessive" (or not) only in relation to other kinds of consumption.[11]

Over the next quarter of a century or so, we may take some solace, as Joseph Nye does, in the fact that America's power and influence in the world system has a "soft," noneconomic, component, drawing on the appeal of our values and ideals. Even so, our ability to call on these unless they happen to fit with the national interests of others, or to persuade others by example, will surely grow more tenuous as the "hard" assets of economic resources (and the respect engendered by our ability to create them) diminish, especially if the track is steadily downward and the national will to reverse course is lacking.

Still, there is a bright side to this macroeconomic perspective. Although the analysis shows that, absent basic behavioral changes, the imbalances in trade and investment will persist, it also demonstrates that our economic fate is, to a considerable degree, in our own hands.

The coming decades therefore offer a window of opportunity to halt the process of cumulative decline or a window of vulnerability to witness the deterioration of American capabilities.